ST 01-0037-PLR 08/30/2001 COMPUTER SOFTWARE

This letter presents rulings regarding whether the licenses at issue qualify as licenses of computer software under 86 Ill. Adm. Code 130.1935. (This is a PLR).

August 30, 2001

Dear Xxxxx:

This Private Letter Ruling, issued pursuant to 2 Ill. Adm. Code 1200 (see enclosed), is in response to your letter of March 12, 2001 and follow up correspondence of April 26, 2001 and June 29, 2001. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of the Section 1200.110 appears to be contained in your request. This Private Letter Ruling will bind the Department only with respect to COMPANY for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

In your letter, you have stated and made inquiry as follows:

COMPANY is requesting a formal Private Letter Ruling on the applicability of sales tax to the matter described below. This request is made under Department Regulation 1200.110. COMPANY requests that all confidential information and supporting documentation be deleted from any public issuance of this letter ruling.

Documents Provided:
A copy of the Proposal and Exhibits, License Agreement, COMPANY Purchase Order Form, NAME End-User License Agreement, and COMPANY License Agreement (amendment) between COMPANY and BUSINESS are enclosed.

Tax Period at Issue:
The tax period for this matter is the year 1997. COMPANY is not under audit by the state of Illinois nor is it involved in any litigation with the state of Illinois.

Previous Rulings on This Issue:

To the best knowledge of COMPANY and its representative, the Illinois Department of Revenue has not ruled on this same issue before for COMPANY In addition, COMPANY has not previously withdrawn a request for a letter ruling on this matter before a ruling was issued.

Statement of Facts:
COMPANY sells computer hardware, software and related computer services, which provide various office management services to insurance agents. COMPANY is a STATE corporation and does not maintain offices in Illinois. It does have traveling sales

and maintenance personnel who may contact customers and/or provide services in Illinois. COMPANY collects sales tax on taxable sales from its Illinois customers and remits it to the Illinois Department of Revenue.

On November 5, 1997, COMPANY sold computer hardware, software and related services to (BUSINESS) in CITY, Illinois for a total price of $$$, pursuant to a License Agreement. Included were charges for:

BRAND software	$ $$	
Workstation licensing fees	$$	
NAME software maintenance	$$	
Installation	$$	
Customization of canned software		$$
Additional software and maintenance	$$	

The software is canned software and was provided to the BUSINESS on disks through the mail. The additional software included the NAME, which is canned software resold by COMPANY. NAME is a database that is often used in conjunction with the software.

The software customization consisted of (1) integration of the software with the BUSINESS's existing systems, (2) forms set up, and (3) modification of file maintenance programs to adapt SOFTWARE to BUSINESS's coding system. The canned software programming was not changed by the customization. The customization was billed separately from the canned software.

The purchase of telephone support and maintenance was required for the duration of their contract. The support and maintenance were billed together as one price, which also included periodic software updates that were supplied on disk.

Since the original purchase in 1997, BUSINESS has received monthly billings for support of about $$$ per month, and several more customization charges. Monthly billings for support include telephone support, software maintenance and software updates.

Statement of Authority and Explanation:

Illinois Regulation, Section 130.1935 defines computer software. Subsection (a) states that 'canned software is considered to be tangible personal property regardless of the form in which it is transferred or transmitted'. 'The sale at retail, or transfer, of canned software intended for general or repeated use is taxable'. Subsection (a)(l) states 'a license of software is not a taxable retail sale if: (A) it is evidenced by a written agreement signed by the licensor and the customer; (B) it restricts the customer's duplication and use of the software; (C) it prohibits the customer from licensing, sublicensing or transferring the software to a third party; (D) the vendor will provide another copy at minimal or no charge if the customer loses or damages the software; and (E) the customer must destroy or return all copies of the software to the vendor at the end of the license period.

Considering the five requirements for the license of software to be a nontaxable retail sale: (A) the licensing of the COMPANY software was evidenced by a written agreement signed by the licensor and the customer; (B) the Agreement restricted the duplication and use of the software; (C) it prohibited the customer from licensing,

sublicensing or transferring the software to a third party; and (E) it required the customer to destroy the software at the termination of the contract. The License Agreement was silent about providing the customer with a copy of the software (item D in the Regulations) upon the loss or destruction of the original copy. The Illinois Department of Revenue has deemed that this provision for licensing is met if the agreement does not contain such a provision but the vendor's records reflect that it has a policy of providing copies of software at minimal cost. COMPANY charges $$$ to replace lost or damaged software, which would constitute a minimal charge. The Agreement requires the customer to destroy the software at the termination of the contract (item E) but COMPANY has never enforced that requirement. COMPANY believes that under the qualification for licensing, all of the COMPANY software, customization, installation, and subsequent support and software updates are not taxable.

Section 130.1935(c)(1)(B)(3) states 'The selection of pre-written or canned programs or program modules assembled by the vendor into a software package does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. If the pre-written program or module was previously marketed, the new program will qualify as a custom program if the price of the pre-written program was 50% or less of the price of the new program.' The software is a canned software program that was sold to many customers before and after the sale to BUSINESS. The $$$ of customization made to SOFTWARE comprises about 20% of the total price of the software, licensing and customization of $$$. Under this premise since was pre-written software, the amount of customization did not account for more than 50% of the price, and the customization became part of the software, the entire amount of $$$ would taxable as canned software if the software did not qualify as nontaxable licensing.

The NAME database software is resold by COMPANY pursuant to NAME End-User License Agreement. NAME is not covered by the COMPANY License Agreement. The NAME License Agreement is only signed by the purchaser and it does not provide for replacement of the software at a minimal cost. Since the NAME software is not licensed by the COMPANY License Agreement and the NAME End-User License Agreement lacks two requirements to qualify as nontaxable licensing, the NAME software and support, which includes software updates, are taxable even though the software is used in conjunction with COMPANY' nontaxable licensing.

Ruling Requested

COMPANY requests that the Department review all of the information provided with this request and rule that the following items are or are not subject to Illinois Retailers' Occupation Tax and Use Tax:

(1) the COMPANY licensing, software, installation, and support are nontaxable licensing,
(2) the COMPANY licensing, software, installation and support do not qualify as custom software. Therefore, these products would be taxable as canned software if they did not qualify as nontaxable licensing, and
(3) the NAME licensing, software, and support are taxable

Your prompt attention to this matter will be greatly appreciated.

This ruling is based upon the facts and materials provided, including your letters of March 12, 2001, April 26, 2001, and June 29, 2001, the "COMPANY BRAND Agency Management System Proposal," the "License Agreement," "Exhibit A," "Exhibit B," "Exhibit C," the "Amendment to COMPANY License Agreement For BUSINESS" the "COMPANY License Agreement For BUSINESS" the "COMPANY BRAND System Purchase Order Form," the "NAME End-User License Agreement," and information provided by telephone.

Due to the lack of clarity regarding which software is covered by which license and what dollar amounts are attributable to the purchase of the software and services at issue, we will rule only in regard to whether or not the licenses in question qualify as nontaxable licenses of software.

LICENSE AGREEMENT:

Generally, sales of "canned" computer software are taxable retail sales in Illinois. See the enclosed copy of 86 Ill. Adm. Code 130.1935. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. As set forth in the Department's rules in effect in 1997, "a license of software is not a taxable retail sale if:

A) it is evidenced by a written agreement signed by the licensor and the customer;

B) it restricts the customer's duplication and use of the software;

C) it prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party);

D) the vendor will provide another copy at minimal or no charge if the customer loses or damages the software; and

E) the customer must destroy or return all copies of the software to the vendor at the end of the license period."

The License Agreement ("Agreement") is a written agreement signed by the licensor and the customer. Section 3 of the Agreement restricts the customer's duplication and use of the software. Section 3 also prohibits the customer from assigning, renting, leasing, selling, displaying or otherwise disposing of the software to any third party except with written permission from COMPANY. The vendor has a policy of providing another copy of the software at minimal charge if the customer loses or damages the software. Section 4 of the Agreement provides that the customer must destroy all copies of the software at the end of the license period. Because the License Agreement meets all the criteria for a license of software, it qualifies as a license of software not subject to sales tax.

NAME END-USER LICENSE AGREEMENT:

The NAME End-User License Agreement is a written agreement signed only by the licensee. The provisions under "TITLE" restrict the customer's duplication and use of the software. The provisions under "LICENSE" prohibit the customer from renting, leasing, transferring or distributing the NAME. There are no provisions for the vendor to provide another copy at minimal or no charge

for lost or damaged software, nor has there been any representation that the vendor has such a policy, although the customer does have the right to make copies for back-up or archival purposes. The provisions under "TERM" require the customer to destroy or return the NAME to NAME at the end of the license period. Because the NAME End-User License Agreement does not meet all the criteria for a license of software, it does not qualify as a license of software not subject to sales tax.

There is confusion in your representations regarding whether the NAME software is transferred subject to the License Agreement or the NAME End-User License Agreement. We do not believe it can be subject to both agreements at once. There is no language in the License Agreement clearly representing that it covers the NAME software. The NAME End-User License Agreement states that the NAME is licensed only on the terms of the NAME End-User License Agreement and that the right to use the NAME is acquired directly from NAME, even though distributed by other persons.[1] It is our opinion that the NAME software is subject to the NAME End-User License Agreement. The information presented in the materials you have provided establishes that the $$$ licensing fee "includes both the licensing of NAME and BRAND." No information was provided regarding the charges attributable to each software package. This being the case, any portion of the $$$ licensing fee which is attributable to the NAME software would be taxable.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

I hope this information is helpful. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

Very truly yours,

Martha P. Mote
Associate Counsel

MPM:msk
Enc.

[1] The NAME End-User License Agreement directs licensees who have questions regarding the Agreement to contact NAME in STATE.